No. 12,159

IN THE

United States Court of Appeals

For the Ninth Circuit

In the Matter of
THE WESTERN PACIFIC RAILROAD COMPANY,
Debtor.

THE WESTERN PACIFIC RAILROAD CORPORATION,
Appellant,

vs.

THE WESTERN PACIFIC RAILROAD COMPANY,
Appellee.

BRIEF FOR APPELLANT.

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PERNAU-WALSH PRINTING CO., SAN FRANCISCO

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BRIEF FOR APPELLANT.

This is an appeal by The Western Pacific Railroad Corporation, Petitioner and Plaintiff below, herein referred to as Appellant, from an Order of the District Court signed by Judge Goodman and dated October 28, 1948, denying a Petition of the Appellant for an Order in the proceeding for the reorganization of The Western Pacific Railroad Company, Debtor, No. 26591-S. (Tr. 249-250.) The Appellant's petition asked

entry by the District Court of an Order (See Attachment A, Tr. pp. 193-195) designed to remove any reasonable doubt as to its right to file an Amended Bill of Complaint in the District Court in an action No. 26333-H originally entitled The Western Pacific Railroad Corporation, Plaintiff, against Sacramento Northern Railway, The Western Pacific Railroad Company and American Trust Company of San Francisco, as Trustee under the Indenture executed by Sacramento Northern Railroad (a predecessor company) as of July 1, 1918, as Defendants. (Tr. 151-152.)

The original Bill of Complaint in the last mentioned action, sought to establish a highly meritorious claim, undisputed save as it is sought to be defeated by a plea of limitation, which we deem abortive, against Sacramento Northern Railway in the amount of $1,441,390.55 and to enforce payment thereof by the reorganized Western Pacific Railroad Company which had acquired under the reorganization all of the capital stock and various items of alleged indebtedness of said Sacramento Northern Railway. (Tr. 120-136; 186.)

By order of the late Judge A. F. St. Sure entered on March 19, 1947, in the above mentioned reorganization proceeding No. 26591-S the filing of the original Bill of Complaint by the Plaintiff against the above-named Defendants was held to violate the injunctive inhibitions of the Court Order entered in that proceeding on March 28, 1946. (Tr. 147.)

The circumstances under which Judge St. Sure's Order of March 19, 1947, had been entered in the reorganization proceeding and the reasons why the Appellant refrained from applying to Judge St. Sure for a rehearing or from appealing from his Order to this Court and why the Appellant deemed it more appropriate and more deferential to the Court to apply for leave to file an Amended Bill of Complaint are stated as follows in the Petition denied by the Court below:

> "On March 19, 1947, an Order was signed by Judge St. Sure at his residence and was sent over to the Clerk of the Court for filing which adjudged the Petitioner to be in contempt; imposed as a penalty that the Petitioner pay to The Western Pacific Railroad Company 'the full amount of all costs, counsel fees and damages paid, incurred or suffered by The Western Pacific Railroad Company on account of the commencing and maintaining of said action No. 26333-H against it' and granted to the Petitioner the privilege of purging itself of such contempt by dismissing within fifteen days as against The Western Pacific Railroad Company its said action No. 26333-H.
>
> "From the recitals in the Order signed by Judge St. Sure on March 19, 1947, it seemed obvious to Petitioner's counsel that he had misconceived the nature of the cause of action set forth in the Bill of Complaint in Action No. 26333-H, which had been carefully limited to be confined within the exceptive provisions of the Order of March 28, 1946, permitting commencement and maintenance of a suit against The Western Pa-

cific Railroad Company on any claim entitled to priority over its pre-reorganization mortgages.

"In this situation any one of three procedures was open to Petitioner—(a) a Petition for Rehearing before Judge St. Sure; (b) an appeal to the Circuit Court of Appeals; or (c) a dismissal of the Bill of Complaint as against The Western Pacific Railroad Company to be followed by the filing of an amended Bill of Complaint under the protection of an Order of Court.

"Counsel for the Petitioner were confident that Judge St. Sure would recognize that he had misconceived the case and would promptly set aside the Order on a Petition for Rehearing but that course was ruled out by his illness.

"There was a patent hazard in an appeal to the Circuit Court of Appeals. If such an appeal had been taken and lost the Petitioner might become liable for heavy counsel fees to be charged by counsel for The Western Pacific Railroad Company on the theory that they had rid it of a liability of $1,441,390.55.

"So the Petitioner determined to dismiss the original Bill of Complaint as against The Western Pacific Railroad Company and thereafter to apply (as it is now doing) for a clarifying or modifying Order under the protection of which it could reimplead The Western Pacific Railroad Company under a new Bill of Complaint revised so as to be more clearly and definitely confined within limits of the exceptive provisions of the Order of March 28, 1946, and amended by superadding a derivative action in favor of the Sacramento Northern Railway and against The West-

ern Pacific Railroad Company which, if successful, would put Sacramento Northern Railway in funds necessary to discharge its indebtedness due the Petitioner."

Judge Goodman denied the Plaintiff's Petition by Order dated October 29, 1948, in the apparent belief as urged by the Defendants that he was concluded by Judge St. Sure's Order of March 19, 1947. (Tr. 217-224; 248)* The Appellant has appealed to this Court in the belief as advised by its Counsel that that is what Judge Goodman thought ought to be done and further that it should not unnecessarily risk another contempt proceeding in order to assert rights which they believe to be justiciable and not within the scope of, or cut off, barred or affected by the injunctive Order of March 28, 1946—all as is developed in the following:

*The remarks of Judge Goodman are not reproduced because Counsel for Defendants insisted (we think most unreasonably and erroneously) that what the Judge said from the bench is not a proper part of the Record on Appeal. The Appellant's Points had been drawn and filed below before that position had been taken by Defendants' Counsel and had been drawn upon the assumption (which we believe to be correct) that Judge Goodman exercised no independent judgment but, in view of a prior Order made by a co-ordinate Judge, had been led to believe that the matter should be sent to the Court of Appeals.

ARGUMENT.

I.

THE LEARNED DISTRICT COURT ERRED IN HOLDING THE ORDER MADE ON MARCH 19, 1947, BY JUDGE A. F. ST. SURE TO CONSTITUTE A BAR TO THE FILING AND PROSECUTION OF THE CAUSE OF ACTION OR CAUSES OF ACTION ALLEGED IN THE PROPOSED AMENDED BILL OF COMPLAINT AND IN DENYING THE PLAINTIFF'S PETITION. (Tr. 252.)

Regardless of whether Judge Goodman, exercising an independent judgment, intended to decide the point stated in the foregoing headnote, it was a point strongly urged by the Appellee and which we deem erroneous for the reasons developed under the subcaptions lettered A to E as set out below:

A.

The Final Order or Decree of March 28, 1946, in the reorganization proceeding involving The Western Pacific Railroad Company expressly excepts from its injunctive provisions any cause of action against the respondent, The Western Pacific Railroad Company, growing out of interline accounts prior to August 2, 1935, and does not prohibit a derivative cause of action by the plaintiff on behalf of Sacramento Northern Railway against the respondent, The Western Pacific Railroad Company, to recover amounts due under just and equitable divisions of revenues from business interchanged prior to August 2, 1935. (Tr. 253.)

As shown above, the Appellant is asserting a claim against Sacramento Northern Railway, undisputed and uncontested (save as payment is sought to be avoided by a plea of limitation) in the amount of $1,441,390.55 which represents principal and interest of the purchase money, or part of the purchase money, for valuable traffic-producing feeder-lines of

railroad acquired by Sacramento Northern Railway and which have been continuously operated by it during three separate operating periods for the benefit and enrichment of (a) the pre-reorganized Western Pacific Railroad Company; (b) the Section 77 Reorganization Trustees; and (c) the reorganized The Western Pacific Railroad Company. (Tr. 152-156.) Under these circumstances we think that this Court, guided by the wholesome rule enunciated by the Supreme Court of California in an identical case, will feel constrained to aid the Appellant in the vindication of its equities. The following is from the opinion of the Supreme Court of California in the case of *Booth v. Hoskins,* 75 Cal. 271:

> "The whole case shows that Booth justly owed the defendant all the money claimed by him. It was by the use of the money loaned by defendant that Booth acquired the title to his property now of large value. Common honesty requires a debtor to pay his just debts if he is able to do so, and the Courts, when called upon, always enforce such payments if they can. The fact that a debt is barred by the Statute of Limitations in no way releases the debtor from his moral obligation to pay it. Moreover, one of the maxims which courts of equity should always act upon is, as suggested by the Court below, that he who seeks equity must do equity. In accordance with this maxim we think the plaintiff should be denied any affirmative relief until the money justly due to the defendant is paid."

(For a statement of the facts see Tr. 184-185.)

For reasons that sufficiently appear in the proposed Amended Bill of Complaint, a judgment against Sacramento Northern Railway for $1,441,390.55 may be wholly uncollectable unless the Sacramento Northern Railway can collect amounts aggregating that sum from the reorganized Western Pacific Railroad Company in an action (a) not barred by the Final Decree of March 28, 1946; or (b) upon a subsisting obligation assumed by the reorganized Western Pacific Railroad Company under the Assumption Agreement executed by Order of the reorganization Court; or (c) arising subsequent to the date of reorganization. (See Attachment B, Tr. 216.)

The Sacramento Northern Railway is a wholly-owned subsidiary of the Western Pacific Railroad Company and an integral part of the Western Pacific System, and has been such since 1928. Nevertheless, as a connecting carrier, interchanging traffic of all kinds with the Western Pacific Railroad Company, it has operated, in accordance with the provisions of the Interstate Commerce Act, as a separate and independent railroad (Tr. 152.) Such method of operation was pursued by the Western Pacific Railroad Company prior to August 2, 1935, and thereafter until the appointment of the Reorganization Trustees; the same form of operation was continued by the Trustees during the full period of the trusteeship and since the trusteeship ended has been pursued by the reorganized Western Pacific Railroad Company; but at *no* time during any of these three operating periods has there been an audit and judicial settlement of the inter-line

accounts of and between Sacramento Northern Railway and the Western Pacific Railroad Company and its Trustees. (Tr. 152.)

By clear mandate of the Interstate Commerce Act it was the duty of the Western Pacific Railroad Company prior to August 2, 1935; the duty of the Trustees subsequent to their appointment and prior to December 31, 1944;; and the duty of the reorganized Western Pacific Railroad Company at all times subsequent to December 31, 1944, to establish and maintain fair and equitable divisions in business interchanged with Sacramento Northern Railway to the end that it might discharge its lawful indebtedness including that due the Appellant.

Section 1 provides:

> "It shall be the duty of every such common carrier (any carrier subject to this Act) establishing through routes to provide reasonable facilities for operating such routes and to make reasonable rules and regulations with respect to their operation, and providing for reasonable compensation to those entitled thereto; *and in case of joint rates, fares, or charges, to establish just, reasonable, and equitable divisions thereof, which shall not unduly prefer or prejudice any of such participating carriers.*" (49 U.S.C.A. Sec. 1.)

The authority of the Interstate Commerce Commission in respect of the division of through rates is well implemented by Section 15 (6):

> "Whenever, after full hearing upon complaint or upon its own initiative, the Commission is of opinion that the divisions of joint rates, fares, or

charges, applicable to the transportation of passengers or property, are or will be unjust, unreasonable, inequitable, or unduly preferential or prejudicial as between the carriers parties thereto (whether agreed upon by such carriers, or any of them, or otherwise established), the Commission shall by order prescribe the just, reasonable, and equitable divisions thereof to be received by the several carriers, and in cases where the joint rate, fare, or charge was established pursuant to a finding or order of the Commission and the divisions thereof are found by it to have been unjust, unreasonable, or inequitable, or unduly preferential or prejudicial, the Commission may also by order determine what (for the period subsequent to the filing of the complaint or petition or the making of the order of investigation) would have been the just, reasonable, and equitable divisions thereof to be received by the several carriers and require adjustment to be made in accordance therewith." (49 U.S.C.A. Sec. 15 (6).)

That a good cause of action exists in favor of Sacramento Northern Railway against the Western Pacific Railroad Company cannot be gainsaid if, as is alleged in the Amended Bill of Complaint, the divisions of the rates on traffic interchanged between them have not been fair and equitable and compensatory to Sacramento Northern Railway. This, however, involves a factual inquiry and a readjustment of divisions committed to the Interstate Commerce Commission by the Interstate Commerce Act.* At one time

*Backus Brooks Company v. Northern Pacific Railway, 21 Fed. (2d) 4.

there was a question whether such an inquiry and readjustment could be made retroactively but under a decision rendered by the Supreme Court of the United States on April 22, 1946, it is now clear that they may be so made.** The amended Bill of Complaint is drawn in contemplation of a reference to these special factual issues to the Interstate Commerce Commission precisely as special factual issues are referred to Special Masters in conformity with the usages of Chancery and to this end the Amended Bill of Complaint asks, *inter alia*—

> "That the Plaintiff herein be authorized in the name of, or on behalf of the defendant, Sacramento Northern Railway, to apply to the Interstate Commerce Commission for any administrative or other relief under the amended Interstate Commerce Act which may be necessary or proper in connection with the establishment, both retrospectively and prospectively, of just and reasonable divisions of carrier revenues on business interchanged between Sacramento Northern Railway and the defendant, The Western Pacific Railroad Company, or in connection with a judicial settlement of their accounts." (Tr. 216.)

The foregoing shows the nature of the claim in respect of which the Appellant as a creditor of Sacramento Northern Railway suing in its behalf seeks to implead the reorganized Western Pacific Railroad Company. Whether it will succeed in establishing such claim in its behalf is the issue to be determined in the proposed law suit.

***El Dorado Oil Works and El Dorado Terminal Company v. The United States of America, et al.*, 328 U.S. 12.

The question here and now presented is: is the law suit one that is or is not barred by the injunctive Order of March 28, 1946? Or, stating the question in even a narrower form—Is the proposed law suit one that may be brought as being within the exceptive provisions of the Order of March 28, 1946?

A discussion of this question is an appropriate, if not a necessary background of an intelligent consideration of the defense of *res adjudicata* upon which the Appellant seems to place great reliance.

At this point it will be in order to direct this Court's attention to the terms of the injunction which the Appellant was held to have violated in filing the original Bill of Complaint. This Order, which bears date March 28, 1946, provides in Paragraph 6 as follows, the italics emphasizing the exceptive provisions being our own:

> "All persons, firms, and corporations whatsoever, and wheresoever situated, located or domiciled, are hereby perpetually restrained and enjoined from instituting prosecuting, or pursuing, or attempting to institute, prosecute or pursue, any suit or suits or proceedings in law or in equity, or otherwise against The Western Pacific Railroad Company, or against the successors or assigns of said Company, or against any of the assets or property of said Company or its successors or assigns, directly or indirectly, on account of or based upon any right, claims or interest of any kind or nature whatsoever which any such person, firm or corporation may have had in, to or against the Debtor, or any of its assets or properties, on or before December 28, 1944 (*ex-*

cept as specifically provided for or permitted by prior order of this Court), and from interfering with, attaching, garnishing, levying upon, enforcing liens against or upon, or in any manner whatsoever disturbing any portion of the property, real, personal, or mixed, of any kind or character, now or hereafter belonging to or being in the possession of said Company, and from interfering with or taking steps to interfere with said Company, its officers and agents, or the operation of the lines of railroad or properties or the conduct of the business of said Company, by reason or on account of any obligation or obligations incurred by the Debtor or by the Trustees of the Debtor's estate on or before December 28, 1944 *(except as specifically provided for or permitted by prior order of this Court),* and all such persons, firms and corporations are also hereby restrained and enjoined from prosecuting against the Reorganization Committee, or any of them, their agents or attorneys, or against the Trustees of the Debtor's estate, or either of them, their agents or attorneys, or against the said Company, its agents or attorneys, any suit or proceeding arising out of, or based on, any act or acts done or omitted to be done in putting into effect and carrying out the plan of reorganization or any order of this Court entered in these proceedings."

Little more need be said about the injunctive Order of March 28, 1946; the exceptive clauses, which as set out above have been italicized, to be brought conspicuously to the attention of the Court, clearly contemplate and authorize the institution of suits to enforce against the reorganized Railroad Company any and all claims against said Railroad Company or its

Trustees, payment of which was specifically provided for or permitted by prior Orders of the Court by the Railroad Company or its Trustees out of the income of the trust estate.

The only remaining question is, therefore, were the Trustees authorized by appropriate Orders of Court to pay out of the impounded income of the trust estate claims "arising out of rate divisions" or "interline settlements".

In the Amended Bill of Complaint it is alleged that revenues derived by the Western Pacific Railroad Company from business interchanged with Sacramento Northern Railway approximate or exceed $20,000,000 (Tr. 207-210.) Any part of that amount which may be recovered by Sacramento Northern Railway under the allegations of the Amended Bill of Complaint for the period *prior* to August 2, 1935, when the reorganization proceeding was commenced will be upon a claim "arising out of rate divisions" or "interline settlements" and would be a claim prior and preferential to mortgage liens resting upon the property of the Western Pacific Railroad Company on that date and would be a claim directed by Order of the Court dated August 2, 1935 (sometimes referred to as Order No. 1) to be paid out of current income "regardless of when accrued". (Tr. 5 (c).)

By subsequent Order of Court appointing the Trustees they were authorized and directed to conduct the business of the Western Pacific Railroad Company in its own corporate name and through its own corporate officers (but subject always to the direction of

the Trustees) and to exercise all of the powers, provisions, duties and obligations theretofore granted to and imposed upon the Western Pacific Railroad Company pursuant to Order No. 1 which as above set forth included express authority to pay "claims arising out of rate divisions" and "interline settlements" as well as other specified operating items "regardless of when accrued". (Tr. 5 (c); 20-21.)

These orders continued in full force and effect throughout the Trusteeship and thus were in effect and in contemplation when the Court made what is sometimes referred to as the Revesting Order dated November 27, 1944, under which the reorganized Western Pacific Railroad Company was required to execute the Assumption Agreement hereinbefore mentioned. (Tr. 74-99.)

Under the provisions of the Assumption Agreement exacted by the Court the reorganized the Western Pacific Railroad Company was required to assume and did

> "Assume any and all outstanding current liabilities and obligations incurred by said Trustees and without limitation thereto, any and all liabilities or obligations of the debtor in possession of said Trustees with respect to claims for personal injury or death for loss or damage to property and generally any and all liabilities and obligations with respect to claims of any character whether heretofore or hereafter asserted arising out of the possession, use or operation of the debtor's properties by said Trustee, or their conduct of the debtor's business, including liabilities

and obligations hereafter arising up to midnight December 31, 1944." (Tr. 101.)

It would serve no useful purpose to prolong the argument. The Amended Bill of Complaint not only alleges a cause of action that is clearly excepted from the injunctive provisions of the Order of March 28, 1949, but a cause of action which the Court expressly required the reorganized Western Pacific Railroad Company to assume as a part of the purchase price of the properties revested in it pursuant to the Plan of Reorganization.

B.

The proposed Amended Bill of Complaint contains the following restrictive paragraph not appearing in the original Bill of Complaint considered by Judge St. Sure, under which the Amended Bill of Complaint, in so far as it sets forth a derivative cause of action in favor of Sacramento Northern Railway, expressly excludes any cause of action not falling within the exceptive provisions of the Final Order or Decree of March 28, 1946:

"Anything herein to the contrary notwithstanding this amended Bill of Complaint to the extent that it seeks a money judgment or decree in favor of Sacramento Northern Railway and against The Western Pacific Railroad Company in respect of the period prior to December 31, 1944, is hereby limited to such amounts, if any, as are found due from The Western Pacific Railroad Company to Sacramento Northern Railway upon a judicial settlement of their inter-line accounts for the period prior to August 2, 1935, and are entitled to priority over the then existing mortgage indebtedness of the defendant, The Western Pacific Railroad Company, and to such amounts, if any, as are found to be due upon a judicial settlement of the inter-line accounts of Sacramento Northern Railway and the Trustees for the period August 2, 1935 to December 31, 1944, and payment of which is a liability of the defendant, The Western Pacific Railroad Company, under the Assumption Agreement executed pursuant to the Order of this Court dated November 27, 1944." (Tr. 253-254.)

As to what led Judge St. Sure to the conclusion that the original Bill of Complaint ran counter to the injunctive provisions of the Order of March 28, 1946, we cannot know since he wrote no opinion. We conjecture, however, that he yielded to the Appellee's contention that the Appellant was seeking to enforce "an unsecured claim, not entitled to priority over any mortgage, when it accrued in 1928, as alleged in the Bill of Complaint and that as appears from the Bill

of Complaint, it continued to be an unsecured claim and not entitled to priority over any mortgage throughout the entire period of more than sixteen years from the date of its alleged accrual until the consummation of the reorganization of the Western Pacific Railroad Company." (Tr. 146.)

That our conjecture is the correct one seems to be supported by the following recital in Judge St. Sure's Order of March 19, 1947:

> "That in and by said action The Western Pacific Railroad Corporation has asserted and now asserts a claim against the Petitioner which, if it exists at all, existed on or before December 28, 1944, and was released and discharged by said Final Order; *and that the commencement of said action is not and has not been provided for or permitted by any Order of this Court.*" (Tr. 149.)

Of course, Judge St. Sure was referring only to the Appellant's claim against Sacramento Northern Railway and was not referring to any claim that Sacramento Northern Railway or any other connecting rail carrier might have against the reorganized Western Pacific Railroad Company "arising out of rate divisions" and "interline settlements" because claims of that character were expressly provided for and permitted by Paragraph (E) of the Order of Court entered August 2, 1935, "regardless of when accrued". (Tr. 5.)

The Amended Bill of Complaint has been so drawn as to eliminate the objection that apparently was in the mind of Judge St. Sure and to set forth a deriva-

tive cause of action against the reorganized Western Pacific Railroad Company not in favor of the *Appellant* but in favor of Sacramento Northern Railway and a cause of action falling squarely withinn the exceptive provisions of the Order of March 28, 1946.

To avoid any possible question, however, as to the true nature of and the express limitations upon the cause of action intended to be alleged against the reorganized Western Pacific Railroad Company there was inserted in the Amended Bill of Complaint in addition to allegations fixing its character as a derivative cause of action the following provision:

> "Anything herein to the contrary notwithstanding this amended Bill of Complaint to the extent that it seeks a money judgment or decree in favor of Sacramento Northern Railway and against The Western Pacific Railroad Company in respect of the period prior to December 31, 1944 is hereby limited to such amounts, if any, as are found due from The Western Pacific Railroad Company to Sacramento Northern Railway upon a judicial settlement of their inter-line accounts for the period prior to August 2, 1935, and are entitled to priority over the then existing mortgage indebtedness of the defendant, The Western Pacific Railroad Company, and to such amounts, if any, as are found to be due upon a judicial settlement of the inter-line accounts of Sacramento Northern Railway and the Trustees for the period August 2, 1935 to December 31, 1944, and payment of which is a liability of the defendant, The Western Pacific Railroad Company, under the Assumption Agreement executed

pursuant to the Order of this Court dated November 27, 1944." (Tr. 212-213.)

Manifestly, this excludes from the Amended Bill of Complaint any allegation, or perhaps more correctly speaking sterilizes any allegation that could possibly be construed as violating the injunction. In its practical application it will eliminate accountability for unfair and inequitable divisions in any period prior to August 2, 1935 for which the claim would not be preferential. The Appellee argued before Judge St. Sure that the so-called six months rule would apply to this class of claims and there is some authority to support that contention although Judge St. Sure authorized payment of all such claims "regardless of when accrued.* (Tr. 5.) Whether claims of this character growing out of interchanged traffic are affected by the six months rule as contended by the Appellee or are preferential "regardless of when accrued", as was the view of Judge St. Sure is a

*In 3 Jones on Bonds and Bond Securities, 4th Ed. Section 1356, page 145, it is stated: "The class of preferred debts to be so paid includes taxes on the property; the wages of officers and employees of every grade operating the road; the cost of material and supplies; * * * and balances due other railroads and lines of transportation on account of passenger tickets and freight charges." Citing *Farmers Loan and Trust Company v. Vicksburg & M. R. Company,* 33 Fed. 778. And in the same volume, Section 1358, page 149, the author further says: "Under the principle just discussed is also included the payment of limited amounts due connecting roads for materials and repairs and for unpaid ticket and freight balances, the outcome of indispensable business relations where an interruption of such relations could be a probable result in case of non-payment", citing *Miltenberger v. Logansport Railway Company,* 106 U.S. 286; *Farmers Loan and Trust Company v. Vicksburg & M. R. Co.,* 33 Fed. 778; and *Easton v. Houston & T. C. Ry. Co.,* 38 Fed. 12.

question relating to the *merits* of the controversy and not in any sense whatever to the right of the Appellant to file an Amended Bill of Complaint for the settlement of the controversy.

C.

The Assumption Agreement executed by the defendant, The Western Pacific Railroad Company, renders it liable in a derivative action in favor of Sacramento Northern Railway by this appellant to recover amounts due under just and equitable division of revenues from business interchanged with Thomas M. Schumacher and Sidney M. Ehrman, Trustees in Reorganization, subsequent to August 2, 1935, and prior to December 31, 1944. (Tr. 254.)

Attention already has been directed to the text of the Assumption Agreement which is the *nexus* of the right of the Appellant, suing for the account of Sacramento Northern Railway, to recover for it from the reorganized Western Pacific Railroad Company what may be justly and equitably due under readjusted divisions of revenues from business interchanged between the two carriers. It is hardly necessary to discuss the relationship or lack of relationship between the Assumption Agreement and the injunctive Order of March 22, 1946. The injunctive Order was the customary Order entered mainly for the purpose of protecting outgoing Trustees against litigation or claims discharged by the Bankruptcy proceeding and not to facilitate evasion by the reorganized Western Pacific Railroad Company of payment of just claims growing out of the operation of the railways by the Trustees. And it has been customary to require those who receive the assets from Receivers and Trustees to enter into Assumption Agreements whereby those

who have claims arising out of the acts of the Receivers or Trustees would be protected despite the discharge of the Receivers or Trustees from personal liability.

Texas and Pacific Railway Company v. Johnson, 151 U.S. 81;

Texas and Pacific Railway Company v. Bloom, 164 U.S. 636;

Glenn on Liquidation, Sec. 165, pp. 273, 274;

Clark on Receivers, Sec. 495, p. 677;

Hanlon v. Smith, 175 Fed. 192;

Stuart v. Dickinson, 235 S.W. 446 (Mo.);

Anderson v. Chicago, Rock Island and Pacific Railroad Company, 175 N.W. 583 (Iowa); and

45 *Am. Jur.* 276, where in Sec. 345 the author states:

"Furthermore, a railroad company is liable for any claim which should have been paid by the receiver out of earnings of the railroad, although the claim is not established by intervention within the time fixed by the Order of the Court."

D.

The Decree of March 28, 1946, and the Order made by Judge St. Sure on March 19, 1947, do not extend to or prohibit the prosecution by the plaintiff and appellant herein of a derivative cause of action against The Western Pacific Railroad Company to recover amounts due under just and equitable division of revenues from business interchanged subsequent to December 31, 1944. (Tr. 254.)

In addition to what may be found due Sacramento Northern Railway upon a retroactive adjustment of revenue divisions from business interchanged with the

Trustees prior to December 31, 1944, there will be further amounts due for the period subsequent to December 31, 1944, when the Trusteeship operations ended. Of course, neither the Decree of March 28, 1946, nor the Order of Judge St. Sure entered March 19, 1947, extends to or relates directly or indirectly to what accrued when operations were resumed by the reorganized Western Pacific Railroad Company. The Appellee has not yet had the hardihood to suggest that the injunctive Order was intended to freeze for the future the unlawful and inequitable divisions of revenue alleged to have been in effect during the period of trusteeship.

E.

The Final Order or Decree of March 28, 1946, and the Order of Judge St. Sure entered March 19, 1947, do not prevent or purport to prevent the plaintiff and appellant, The Western Pacific Railroad Corporation, from joining in a suit properly instituted and pending against Sacramento Northern Railway, which was not a party to the reorganization proceeding, wherein said March 19, 1947 Order was entered, any proper or necessary party to a complete determination of such cause of action against Sacramento Northern Railway, even though such proper or necessary party happens to be the respondent, The Western Pacific Railroad Company, or any other party to said reorganization proceeding. (Tr. 255.)

The Appellant's immediate objective is to require the reorganized Western Pacific Railroad Company to pay to Sacramento Northern Railway, its wholly-owned subsidiary, what may be due on a retroactive readjustment of divisions on railway traffic interchanged between the two Companies from the most recent practicable date to a date far enough back to

bring the reparations up to $1,441,390.55 with interest from June 30, 1945. (Tr. 180.)

There is a possibility (perhaps a remote one) that reparations up to that amount may be awarded by the Interstate Commerce Commission on business in the third operating period; that is, business transacted by the reorganized Western Pacific Railroad Company after January 1, 1945, in which event it will not be necessary to go back to the period of trusteeship operation which ended December 31, 1944; and there is a further possibility—perhaps even a probability—that reparations awarded for any shortage attributable to the period subsequent to January 1, 1945, will be made up on business transacted in the period of trusteeship or some part thereof. But if in order to secure full satisfaction it be necessary for the Appellant to go back of both of these periods into the period antedating the filing of the petition in bankruptcy on August 2, 1935, the Appellant contends that this period is open for reparations notwithstanding the final Order of March 28, 1946, and notwithstanding any statute of limitations.* If by the above process sufficient money can be put into the treasury of Sacramento Northern Railway to satisfy the Appellant's claim, then a judicial question will arise as to whether the indebtedness which the Appellee claims is due to it from Sacramento Northern Railway aggregating more than $22,964,324 must not

*The reason why the Order of March 28, 1946, is inapplicable has been fully developed; the reason why the Statute of Limitations is inapplicable is that inter-line settlements are running accounts with day to day entries.

in equity and good conscience be subordinated to the Appellant's claim in the amount of $1,441,390.55, with interest from June 30, 1945, so that the full amount of the debt due the Appellant by Sacramento Northern Railway may be paid over by it to the Appellant.*

Should, however, the Appellant fail to establish in favor of Sacramento Northern Railway a claim for all or any part of the amount so alleged to be recoverable by it, that is to say, should the derivative cause of action alleged in the Amended Bill of Complaint in favor of Sacramento Northern Railway and against the reorganized Western Pacific Railroad Company or any part thereof fail; and as a consequence of such failure should the Appellant be obliged to resort to a judicial sale of the property of Sacramento Northern Railway which is encumbered by liens held by the reorganized Western Pacific Railroad Company a like question will arise with respect to the proceeds of such a sale: a question whether in equity and good conscience the indebtedness held against Sacramento Northern Railway by the reorganized Western Pacific Railroad Company must not be subordinated to the Appellant's claim in the amount of $1,441,390.55, with interest from June 30, 1945.

In this connection it is important that this Court understand that Sacramento Northern Railway was not a party to the reorganization proceeding No.

*The Appellant contends that this indebtedness if valid is a contribution of capital to a stock owned subsidiary; such indebtedness ranks on a parity with such stock and is subordinate to third party owned indebtedness.

26591-S. All that the reorganized Western Pacific Railroad Company acquired under the so-called Revestment Order respecting Sacramento Northern Railway was (a) its capital stock; (b) most but not all of its First Mortgage Bonds outstanding in the amount of $5,312,475; and (c) all of its unsecured indebtedness except that part thereof held by the Appellant and amounting as of June 30, 1945, to $1,441,390.55. (Tr. 186.)

Of course, the reorganized Western Pacific Railroad Company acquired all of these various claims against Sacramento Northern Railway subject to existing equities of third parties and it goes without saying that the Appellant and any other party having a claim against Sacramento Northern Railway cannot enforce these equities unless it can implead the reorganized The Western Pacific Railroad Company. The Western Pacific Railroad Company is a necessary party to any proceeding in which the holders of indebtedness against Sacramento Northern Railway seek to enforce that indebtedness against its funds or its property in priority to like claims held by the reorganized Western Pacific Railroad Company.

The injunctive provisions of the Order of March 28, 1946, in No. 26591-S, do not purport to bar the joinder of the reorganized Western Pacific Railroad Company in a suit of that character; and, we submit, if the Reorganization Court had undertaken to interfere with such a proceeding against Sacramento Northern Railway, which was not a party to the re-

organization proceeding, by enjoining joinder of a necessary party its action would have been void as beyond the Bankruptcy Court's jurisdiction, which extends only to "the debtor and its property". (Title 11, U.S.C.A. Sec. 205(a). The reorganized Western Pacific Railroad Company is in no different or better position respecting its rights and claims against Sacramento Northern Railway than was the pre-reorganized Western Pacific Railroad Company in whose shoes it stands. (*Thompson v. Terminal Shares, Inc.,* 104 F. 2d 1 (8 Cir. cert. den. 308 U.S. 559); *Callaway v. Benton,* 336 U.S. 132. Standing in the shoes of the pre-reorganized Railroad Company the Appellee may not lift itself up by its own boot straps in defiance of natural law.

II.

THE FINAL ORDER OR DECREE OF MARCH 18, 1946, SHOULD BE LIBERALLY CONSTRUED TO PERMIT THE FILING AND PROSECUTION OF ANY LEGITIMATE LAWSUIT NOT WITHIN THE SPIRIT AND INTENT OF ITS RESTRICTIVE PROVISIONS, IN WHICH CATEGORY THIS PROPOSED AMENDED COMPLAINT INDUBITABLY FALLS; IT BEING AXIOMATIC THAT THE DOORS OF THE COURT SHOULD BE AS WIDE OPEN AS THE DOORS OF A CHURCH.

It is not disputed that the Appellant has a valid and enforceable claim against Sacramento Northern Railway for $1,441,390.55, with interest from June 30, 1945, unless, as is asserted by the Appellee, the claim is barred by Limitations. The original Bill of Com-

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plaint as well as the Amended Bill of Complaint alleges facts sufficient to toll Limitations.*

This indebtedness represents the purchase price of property acquired by Sacramento Northern Railway for which payment has not been made, but which the reorganized Western Pacific Railroad Company through its ownership of capital stock of Sacramento Northern Railway is using for its own enrichment.**

Under the doctrine of *Booth v. Hoskins,* 75 Cal. 271 the reorganized Western Pacific Railroad Company will not be accorded equitable relief to which other-

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*On or about February 14, 1933, Sacramento Northern Railway filed with The Railroad Credit Corporation to induce it to make a loan to the pre-organized The Western Pacific Railroad Company a certificate verified by its Auditor certifying that: "There is now owing to The Western Pacific Railroad Corporation from Sacramento Northern Railway the sum of $856,260 in an open book account." From time to time thereafter the Sacramento Northern Railway filed or caused to be filed in each year up to and including at least the year 1944 with the Interstate Commerce Commission and with the federal Commissioner of Internal Revenue properly authenticated financial statements in which said indebtedness was shown as subsisting indebtedness and upon which interest accruals were made in favor of the Petitioner.

**For more than 15 years the defendant, The Western Pacific Railroad Company, has retained all of such revenues without being asked to account to Sacramento Northern Railway for any part thereof so as to provide it with funds for the repayment of the advances made to it by the plaintiff. In such an accounting the defendant, The Western Pacific Railroad Company, as the result of judicial and administrative decisions which stem back to the case of *St. Louis & San Francisco Ry. Co. v. Gill,* 156 U.S. 649, 665, will not be permitted to apply its over-all operating ratio to the business interchanged with its subsidiary, the defendant, Sacramento Northern Railway, but will be accountable to it for all of the revenue derived from the full line haul except the out-of-pocket operating cost applicable thereto. The exact amount of such revenues is unknown and could only be determined as the result of an intricate accounting but the plaintiff alleges that the amount of such revenues approximates or exceeds $20,000,000.

wise it might be entitled until it causes its subsidiary, Sacramento Northern Railway, to observe the dictates of "common honesty" by paying this debt.

The reorganized Western Pacific Railroad Company not only declines to perform this simple act of common honesty but seeks to avoid being required to do so by invoking the injunctive provisions of the final Order or Decree of March 28, 1946, rendered in a proceeding to which Sacramento Northern Railway was not a party and which did not involve the determination of any issue between it and its subsidiary. If a determination of alleged issues between it and Sacramento Northern Railway will put into the treasury of Sacramento Northern Railway moneys with which it may pay its just debt to the Appellant, a result will be achieved which it was not the spirit and intent of the injunctive Order or Decree of March 28, 1946, to interdict; otherwise, *Booth v. Hoskins* is meaningless.

But if, due to the broad language of the Order of March 28, 1946, the proposed Amended Bill of Complaint appears to be prohibited, it is a part of the inherent power of the Court to whom the enforcement of that Order is committed to limit its application in furtherance of justice, because, as stated in the foregoing headnote the doors of the Court should be as wide open as the doors of a church.

Accordingly, the Appellant asks that this cause be remitted to the District Court with directions to enter an Order substantially in the form of Attachment A

to the Appellant's Supporting Memorandum. (Tr. 179; 193-195.)

All of which is respectfully submitted.

Dated, Oakland, California,
May 6, 1949.

LEROY R. GOODRICH,
Attorney for Appellant.

FRANK C. NICODEMUS, JR.,
A. PERRY OSBORN,
Of Counsel.